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SUBJECT: AUSTRALIA AVIATION - EU OPEN SKIES AND RISING FUEL PRICES

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¶1. (SBU) Summary: As Australia and the EU prepare to begin Open Skies talks in September, environmental issues such as emissions will be the hardest point to resolve. Qantas expects to increase its European operations under an Open Skies deal. Qantas and Virgin Blue are both coping reasonably with higher fuel prices, but if prices remain high or go higher, deep cuts could be necessary. End summary.

EU OPEN SKIES NEGOTIATIONS ANNOUNCED

¶2. (SBU) On July 7, Australian Minister for Infrastructure and Transport Anthony Albanese and his EU counterpart, Commissioner for Transport Antonio Tajani, jointly announced the launch of negotiations for an Open Skies aviation agreement. Albanese has been an enthusiastic proponent of such a deal, following on the US-EU and US-Australia Open Skies agreements. Econoff discussed this July 8 with Department of Infrastructure aviation officials Stephen Borthwick (Director for Aviation Markets), Iain Lumsden, and Carla Giuca. They were quite confident about prospects for the negotiations, which will begin with scoping talks in Canberra in September. Commercially, they expect little problem and will push for full access without geographic or frequency restrictions. Borthwick noted, however, that some European carriers such as Lufthansa are concerned about granting access through China and India.

¶3. (SBU) The most difficult issue will likely be aviation emissions, which Borthwick said would probably take a couple of rounds to resolve. The GOA position on the EU aviation emissions restrictions has not changed - this sort of issue should not be handled unilaterally, but should be negotiated through ICAO. Borthwick noted that Australia, which is committed to enacting a domestic emissions trading scheme by 2010, would probably meet EU requirements, but they still want this to be managed multilaterally. Other noncommercial topics such as safety and security will be straightforward, confirming existing arrangements. Borthwick said he expected negotiations to be concluded in early 2009.

USING OPEN SKIES RIGHTS

¶4. (SBU) Qantas government affairs director David Hawes told econoff that Qantas' low-cost subsidiary JetStar is keen to begin flights to Europe once Qantas receives delivery of their new Boeing 787s (scheduled for late 2009, but expected to slip). He added that Qantas itself would probably expand

its flights to Europe beyond its current operations to London Heathrow and Frankfurt. Hawes noted that Australia has bilats with 17 of the EU countries, so an open skies deal open new possibilities. He did not believe Qantas would return to all cities in Europe where it formerly flew, but said they want to return to Paris, where they are restricted to three frequencies by the existing Australia-France bilateral agreement. The GOA does not expect additional European carriers to join British Air in flying to Australia, although more could begin selling seats on code shares.

OPENING TO NON-AUSTRALIAN CARRIERS?

¶5. (SBU) On June 26, Singapore-owned domestic Australian carrier Tiger Air announced its intention to seek rights from the GOA for international flights. JetStar CEO Alan Joyce has publicly opposed any such move, noting that JetStar isn't
Qhas publicly opposed any such move, noting that JetStar isn't allowed to fly to Singapore. Virgin Blue government general manager Tony Wheelens told econoff that, although Virgin Blue had initially supported allowing entirely foreign-owned carriers to fly domestically in Australia to promote competition, Virgin Blue opposed letting such carriers fly internationally. He said that low cost carriers in Asia (which he called "flag of convenience" airlines) have over-ordered aircraft and now have extra capacity. This could be "dumped" into the domestic Australian market, damaging Australian carriers. Wheelens said it might be time to revisit under what conditions foreign-owned carriers are allowed to operate in Australia's domestic market.

COPING WITH RISING FUEL PRICES

¶6. (SBU) Both Qantas (and its JetStar subsidiary) and Virgin Blue have taken steps to cope with rising fuel prices.

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Wheelens said that Virgin Blue (like Qantas and other carriers) has conducted an internal exercise to identify areas where it could save money. In doing this, Virgin Blue wants to protect its expansion plans (including V Australia, scheduled to begin flights to the US in December) and its staff. They have identified A$50 million in savings, cut some nonprofitable domestic routes such as the direct Melbourne-Darwin flight, and retired four older aircraft. Virgin Blue is preparing a second tranche of measures, should aviation fuel prices remain high - and would have to make "savage cuts" if prices went even higher.

¶7. (SBU) Virgin Blue's John O'Callaghan noted that Virgin Blue was in a better position for coping with high fuel prices than Qantas. Its fleet is much younger than that of Qantas, and consequently more fuel efficient and much cheaper to maintain. As a result, O'Callaghan said, in 2007 Virgin Blue enjoyed A$200 million in profits; recent oil price spikes have cost it an additional A$200 million. Qantas made A$1 billion in 2007, but is facing an additional A$2 billion in higher fuel prices. Qantas' Hawes told econoff that, as reported in the press, Qantas was cutting 6% of its capacity, the biggest cut since the outbreak of SARS in 2003. One well-publicized measure Qantas has taken is to cut one Japan route - already becoming less attractive due to the trend of dropping Japanese tourism to Australia. Hawes noted that this spike was quite different than earlier ones - not a market shock like that in 1990-91 with the Gulf War, but a fundamental change in the fuel markets. Without going into detail, he said that "something would have to give" should aviation fuel prices remain high.

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